Col

(4)

No. 06-1413

Supreme Court, U.S.
FILED
JUL 18 2007
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

MEADWESTVACO CORPORATION,
Successor in Interest to THE MEAD CORPORATION,
Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS,
Respondent.

On Petition for a Writ of Certiorari to the Illinois Appellate Court

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONER

ELI J. DICKER *
SHIRLEY S. GRIMMETT
TAX EXECUTIVES INSTITUTE, INC.
1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
(202) 638-5601

* Counsel of Record

Counsel for Amicus Curiae
Tax Executives Institute, Inc.

July 18, 2007

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. BACKGROUND	4
II. THE ILLINOIS APPELLATE COURT MISAPPREHENDED THE COURT'S MANDATE IN *ALLIED-SIGNAL* WHEN IT PERMITTED ILLINOIS TO APPORTION MEAD'S GAIN FROM THE SALE OF A NON-UNITARY COMPANY HELD FOR INVESTMENT PURPOSES	6
CONCLUSION	10

TABLE OF AUTHORITIES

CASES — Page

Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992) ..... *passim*

ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) 7

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) 7

Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) 9

F.W. Woolworth Co. v. Taxation and Revenue Dep't of New Mexico, 458 U.S. 354 (1982) 9

Mead Corp v. Illinois Dep't of Revenue, 371 Ill. App.3d 108, 861 N.E.2d 1131 (2007) 5, 8, 9

Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980)..... 7

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978).. 7

Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959)..... 3, 6

State R.R. Tax Cases, 92 U.S. 575, 608 (1875)..... 7

FEDERAL CONSTITUTIONAL PROVISIONS

U.S. CONST. art I, § 8, cl. 3..... 2, 3, 8

U.S. CONST. amend XIV, § 1 ..... 2, 3, 8

OTHER AUTHORITIES

Sanjay Gupta & Lillian Mills, *How Do Differences in State Corporate Income Tax Systems Affect Compliance Cost Burdens?* (2002) 6

UNIFORM LAWS

Uniform Division of Income for Tax Purposes..... 6

IN THE

Supreme Court of the United States

No. 06-1413

MEADWESTVACO CORPORATION,
Successor in Interest to THE MEAD CORPORATION,
Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS,
Respondent.

On Petition for a Writ of Certiorari to the Illinois Appellate Court

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONER

INTEREST OF *AMICUS CURIAE*

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari.[1] Tax Executives Institute (hereinafter "TEI" or

[1] Pursuant to Rule 37.6, *amicus* Tax Executives Institute, Inc. states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have consented to the filing of this *amicus* brief.

"the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code of 1986 (26 U.S.C.). The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws, reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and vindicating the Commerce Clause and other constitutional rights of all business taxpayers.

TEI has more than 7,000 members who represent more than 3,000 of the leading corporations in the United States, Canada, Europe, and Asia. TEI's members represent a cross-section of the business community whose employers are, almost without exception, engaged in interstate commerce. Therefore, TEI's members have a keen interest in this case, which involves the constitutional limits on the States' ability to impose tax on a nondomiciliary taxpayer's income that bears no connection with the taxpayer's in-state activities.

The Due Process and Commerce Clauses require some definite link—or nexus—between the State and the activity to be taxed. Without such a connection, the state taxing scheme will be struck down as unconstitutional. Here, the State of Illinois impermissibly apportioned and hence imposed tax on the nonunitary, investment income of a multistate corporation—specifically, the gain realized by Petitioner MeadWestvaco Corporation upon the disposition of the assets of another company (Lexis/Nexis) that it held for investment purposes. In sustaining the State's action, the court below distended and effectively disregarded this Court's decision in *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992), which holds that when investment income is derived from activities unrelated to the business activities of a

unitary business, "due process considerations . . . preclude apportionability." *Id.* at 780.

The companies represented by the Institute's membership are directly and materially affected by the rules governing allocation and apportionment of income among the States. By ignoring the Court's teaching in *Allied-Signal*, the Appellate Court of Illinois denied MeadWestvaco the constitutional protections of the Commerce and Due Process Clauses. If permitted to stand, the decision will unsettle the expectations of all multijurisdictional companies, including those represented by TEI. Accordingly, TEI and its members will be directly affected by the disposition of this case.

SUMMARY OF ARGUMENT

In this case, the State of Illinois seeks to tax the gain realized by MeadWestvaco Corporation upon the disposition of another, nondomiciliary company (Lexis/Nexis) that it held for investment purposes. In sustaining the State's attempt, the Illinois Appellate Court distended and effectively disregarded the Court's seminal decision in *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992), which holds that a State may not tax the income of a nondomiciliary corporation if the income is derived from business activities that constitute a distinct business enterprise with business operations unrelated to the business carried on in the State. Thus, while the entire net income of a corporation generated by interstate as well as intrastate activities may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), apportionment is not appropriate in the absence of a formal unitary business unless the asset or transaction in question serves an operational function rather than an investment function. *Allied-Signal*, 504 U.S. at 787.

That threshold is not satisfied here. The two businesses involved were completely separate and distinct. They did not share personnel or make purchases. They maintained separate headquarters, and they had no centralized operations or favorable intercompany transactions.

Under the Illinois court's analysis, investments in wholly owned businesses will, *ipso facto*, be treated as operational assets despite the lack of any unitary relationship between the subsidiary and the parent and without regard to why the company was acquired. Such a result, however, would eviscerate the Court's teaching in *Allied-Signal*, and thus, the petition for a writ of certiorari should be granted and the decision below reversed.

ARGUMENT

I. BACKGROUND

Petitioner, MeadWestvaco Corporation (hereinafter "Mead") is the successor in interest to Mead Corporation, an Ohio corporation, whose primary trade and business is producing and selling forest products, including paper, packaging and paperboard, and school and office supplies. Mead conducted business in several States, including Illinois. In 1968, Mead purchased Data Corporation, an Ohio-based company whose focus was developing ink jet printing technologies as well as the development of a computerized full text information retrieval system. The technology developed by Data Corporation evolved into a computerized full text information retrieval system that later became known as Lexis/Nexis.

After its acquisition of Data Corporation, Mead continued its business of manufacturing and selling paper and office products. Lexis/Nexis eventually became the world's premier provider of online legal information.

During the years it owned Lexis/Nexis, Mead treated the company as a business separate and distinct from its paper

products business. The two businesses did not share personnel or make joint purchases. They maintained separate headquarters and had no centralized operations. The two businesses had different corporate cultures and, in fact, were wholly independent of each other. Simply stated, Mead and Lexis/Nexis did not have a unitary relationship.[2]

In 1994, Mead sold Lexis/Nexis and reported the gain from the sale as nonbusiness income.[3] As nonbusiness income, the gain was not apportionable to (and hence not subject to income taxes) in Illinois and other states.

The Illinois Department of Revenue took issue with Mead's treatment of the gain, asserting that the gain should have been classified as apportionable business income subject to tax in Illinois. Mead challenged the Illinois's reclassification of the gain. The Cook County Circuit Court agreed with Mead that Lexis/Nexis was not part of its unitary business, but, nevertheless held that the gain from the sale of Lexis/Nexis was properly classified as apportionable business income because Mead's investment in Lexis/Nexis served an "operational" function. On appeal, the Illinois Appellate Court upheld the finding of the trial court. The Illinois Supreme Court declined to review this decision.

---

[2] The Illinois Appellate Court did not review the lower court's decision regarding the lack of a unitary business finding. 371 Ill.App.3d 108, 117, 861 N.E.2d 1131, 1139 (2007).

[3] The transaction was structured as an asset sale.

II. THE ILLINOIS APPELLATE COURT MISAPPREHENDED THE COURT'S MANDATE IN *ALLIED-SIGNAL* WHEN IT PERMITTED ILLINOIS TO APPORTION MEAD'S GAIN FROM THE SALE OF A NON-UNITARY COMPANY HELD FOR INVESTMENT PURPOSES

This case presents the question of what connection, or nexus, must exist between a State and a nondomiciliary taxpayer's income from out-of-state sources or activities before that income can be apportioned to, and therefore taxed by, the State. In *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), the Court confirmed that "the entire net income of a corporation, generated by interstate as well as intrastate activities may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Id.* at 460.[4] The general permissibility of formulary apportionment, however, should not obscure or minimize the Constitution's limitation on the States' ability to tax out-of-state income.

To tax the out-of-state income of a nondomiciliary corporation, there must be a "minimal connection between the

---

[4] Apportionment formulae are generally used to determine what part of a taxpayer's income may be properly taxed by the respective States. The purpose of any apportionment formula is to assign to the taxing State the amount of a taxpayer's total income that is earned in, and therefore is reasonably attributable to, the State. In apportioning the income of multistate unitary corporations, some States use the apportionment formula set forth in the Uniform Division of Income for Tax Purposes Act ("UDITPA") that requires a corporation to "separate its income into business income which is subject to apportionment among the various States, and nonbusiness income, which is allocated to a single State." Sanjay Gupta & Lillian Mills, *How Do Differences in State Corporate Income Tax Systems Affect Compliance Cost Burdens?* (2002). UDITPA divides income into business income, which is apportioned by means of a three-factor formula, and nonbusiness income, which is allocated according to the type of income and the type of property giving rise to the income.

interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-37 (1980) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)). A State may not tax the income of a nondomiciliary corporation—such as Mead here—if the income is derived from business activities that constitute a distinct business enterprise with business operations unrelated to the business carried on in the State. *See Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992). Indisputably, that is what Illinois is seeking to do here.

More than a century ago, this Court held that the taxability of a nondomiciliary taxpayer's out-of-state income turned on the application of the "unit rule" or the unitary business principle—on whether the out-of-state item sought to be taxed was "unitary" with, or functionally related to, the taxpayer's in-state activities. *State R.R. Tax Cases*, 92 U.S. 575, 608 (1875). In 1980, this Court encapsulized its prior holdings when it declared in *Mobil Oil Corp.* that the unitary business principle is the "linchpin of apportionability in the field of state income taxation." 445 U.S. at 439. Subsequently, *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), reaffirmed the unitary business principle and established standards for determining whether the requisite link exists between a nondomiciliary taxpayer's business activities within the State and its investments in or income from other entities.

In *Allied-Signal*, the Court explained that the "unitary business rule is a recognition of two imperatives: the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income and the necessary limit on the States' authority to tax value or income that can-

not in fairness be attributed to the taxpayer's activities within the State." 504 U.S. at 780.

Under *Allied-Signal*, the Constitution permits the apportionment of income even in the absence of a formal unitary business where the asset (or transaction) in question serves an operational function rather than an investment function. 504 U.S. at 787. The Court explained that the inquiry whether an asset (or investment or transaction) serves an operational rather than investment function—

> focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing state. It is an inquiry to which our cases give content, and which is necessary if the limit of the Due Process and Commerce Clauses are to have substance in a modern economy.

Id. at 785.

Because the trial court found that there was not a unitary relationship between Mead and Lexis/Nexis, the proper disposition of this case turns on the application of the operational versus investment function test. Based on this test, *Allied Signal* requires reversal of the decision below.

The Appellate Court held that Mead failed its burden of proving "that Lexis/Nexis was not an operational asset," 371 Ill. App. 3d. at 117, 861 N.E.2d at 1139-40, but its analysis proves too much. In reaching this determination, the lower court said: "Mead was 100% owner of Lexis/Nexis. Although Mead did not have day-to-day control over Lexis/Nexis, its involvement with Lexis/Nexis was more than merely passive." *Id.* at 118, 861 N.E.2d at 1140. Thus, under the Illinois court's analysis, investments in all wholly owned companies will be treated as operational assets despite the lack of any unitary relationship between the company and the parent and without regard to why the company was acquired.

Requiring gains from the sale of wholly owned companies, *ipso facto*, to be apportioned without requiring more would distend if not eviscerate *Allied-Signal*. In that case, the State of New Jersey urged the Court to abandon the unitary business principle and allow nondomiciliary states to apportion (and tax) all of a corporation's income without regard to whether the income has a connection with the nondomiciliary state. *Allied-Signal*, 504 U.S. at 784. This Court rightly rejected this theory as sweeping, citing a 1982 discussion that held that the "*potential* to operate a company as part of a unitary business is not dispositive when, looking at 'the underlying economic realities of a unitary business' the dividend income from the subsidiaries . . . [was] derive[d] from 'unrelated business activity' which constitutes a 'discrete business enterprise.'" *Id.* at 784, citing *F.W. Woolworth Co. v. Taxation and Revenue Dep't of the State of New Mexico*, 458 U.S. 354, 362 (1982), (quoting *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 223-224 (1980) (emphasis in original)). Likewise, the potential to integrate a wholly owned company into the parent's operations, without more, is not enough to justify classifying the ownership as "operational" in nature.

The Illinois Appellate Court also said that apportionment is defensible because Mead made contributions of capital and "manipulated" Lexis/Nexis's structure by changing its form from a division to a corporate subsidiary. 371 Ill. App.3d at 118, 861 N.E.2d at 1140. It failed to explain adequately, however, how these activities bolstered its conclusion. Increasing the amount of capital invested in a subsidiary may merely reflect an owner/investor's decision that the subsidiary presents a greater opportunity for return than other investment options. Likewise, transforming a wholly owned subsidiary into a division (or vice-versa) may reflect nothing more than a decision how to hold or own an investment (*e.g.*, as a pass-through entity for tax purposes or as a separate

taxpayer). Neither of these owner/investor decisions by itself reflect an operational purpose.

CONCLUSION

The Court should grant the Petition for a Writ of Certiorari to vivify its decision in *Allied-Signal* and reverse the Illinois Appellate Court's decision.

Respectfully submitted,

ELI J. DICKER *
SHIRLEY S. GRIMMETT
TAX EXECUTIVES INSTITUTE, INC.
1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
(202) 638-5601

* Counsel of Record

Counsel for Amicus Curiae
Tax Executives Institute, Inc.

July 18, 2007